Holding competition hots up

A comparative approach is adopted in this assessment of Italy's realistic potential as a holding company location. By Piergiorgio Valente and Marco Magenta, Studio Associato Legale Tributario (associated with Ernst & Young International), Milan

In the international context, it has become almost imperative for Italian multinational groups to make use of the coordinated efforts and support of other units of the same group.

However, with respect to holding companies, the Italian taxation system has some rather conspicuous loopholes compared to taxation systems in other member states of the EU.

It is, perhaps, helpful to remember that the Italian rules were conceived in the decade before the 1973 reform – at a time when the Italian economy was still deeply entrenched in a typically industrial and partially agricultural economic reality, and which was not particularly orientated towards global corporate activity.

The economic evolution which followed demanded renewal of the Italian tax system. However, legislation limited itself to the introduction of the tax credit for dividends distributed by resident companies, and the 95% exemption on dividends received by Italian parent companies from EU subsidiaries according to the EU Parent-Subsidiary Directive 90/435.

Critical areas of the Italian taxation system that require consideration include: dividends received; capital gains arising from the sale of qualified participations; and the deductibility regime of debt interest paid as a result of the financing needed to acquire qualifying participations.

These criticisms seem particularly relevant when in other member states, for example the Netherlands, Belgium and Luxembourg, tax systems appear to be more up-to-date and efficient. These regimes encourage, rather than hinder, the activity of holding companies.

The tax treatment of dividends received

As far as dividends received are concerned, the existing Italian tax provisions have been properly conceived, at least regarding those dividends distributed by resident companies from which the recipient derives a tax credit equal to (generally speaking) the tax settled by the distributing company. However, when dividends are derived from a foreign source, double taxation may only be eliminated if the exemption under the EU parent-subsidiary regime (see Article 96bis of the Income Tax Code (ITC)) applies.

If any of the requirements to qualify for the application of the above-mentioned rule are not met, the only possible relief from double taxation is foreseen by the affiliation privilege (see Article 96 of ITC), which is applicable to profits distributed by foreign-affiliated companies to their Italian corporate shareholders. However, the exemption granted by this particular rule involves only 60% of the distributed profits, which results in an easing up of international double taxation on distributed profits.

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Consequently, international economic double taxation on dividends distributed may be alleviated, but not completely avoided, since a remarkable portion, equal to 40% of distributed dividends, is considered completely taxable. Up to 100% is taxable whenever the dividends are distributed by foreign-affiliated companies which are resident in a non-EU tax haven.

The non-applicability of the affiliation privilege is justified in view of the assumption that profits obtained (and distributed) by such companies have dodged taxation, thanks to the privileged taxation system in force in tax haven countries.

If that is the case, Italian taxation does not impose economic double taxation on distributed profits. As a matter of course, the granted affiliation privilege would create an unjustifiable benefit of a fiscal nature for the recipient company.

Beyond the possible validity of the assumption just mentioned, what should be remembered with respect to the tax yield, is that the provision lacks a certain efficacy, because it creates a tax incentive for the non-distribution of profits.

The non-applicability of the affiliation privilege may, in other words, cause a loss of tax yield of up to 40% of profits that would, otherwise, have been distributed to Italian companies by their affiliated companies located in non-EU tax havens.

It therefore became preferable to adopt an assumption opposite to that introduced by law no 413 of December 30 1991, which permitted the inclusion of taxable income of, not the distributed profits, but rather the reserves set aside by affiliated companies in tax haven countries.

The envisaged solution drew its inspiration from the rules in force in the UK and France. In particular, Article 209 B of the French *Code Général des Impôts*, states that profits derived from companies established in countries with a privileged tax system are ascribed, irrespective of their actual distribution